United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

74-1252

To be argued by
ANDREW C. HARTZELL, JR.

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket No. 74-1252

AMERICAN AIRLINES, INC.,
Plaintiff-Appellant,

against

AERLINTE EIREANN TEORANTA,
Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF OF PLAINTIFF-APPELLANT

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Introductory Statement

The decisive fact is that AET's aircraft could not have been lawfully registered and used by TCA in the United States, even if there had been no defaults and even if both parties had made maximum efforts to effect such registration. The arbitrators did not decide that registration would have been lawful, but even if they had, a federal court may not give effect to such a determination and, on that basis, award damages. To do so would put the Court in the untenable position of frustrating federal law and of encouraging statutory violations.

Knowing full well that the Agreement would terminate in November 1970 when application for registration of the first aircraft would be made and rejected, AET sought to avoid that inevitable result by abruptly terminating the Agreement on September 2, 1970, *one day* after receiving American's letter con-

firming that it had requested an FAA opinion on the legality of registration. By terminating, AET sought to render the illegality of registration "academic", and to collect more than $13 million in rents as if the aircraft could have been registered. AET is not entitled to such rents any more than it would have been entitled to specific performance requiring TCA illegally to register the aircraft. To award such damages would amount to awarding rents for what would have been the illegal use of foreign aircraft in the United States. A federal court cannot properly exercise its power for such a purpose, regardless of what the arbitrators decided.

By the same token, since the damage provisions in the Agreement are punitive, as American has alleged, those provisions cannot be enforced even if TCA did warrant that they were lawful (which it did not). To rule otherwise, as the District Court has done, would require the federal courts to implement an illegal contract provision whenever the contracting parties warranted that the provision was lawful. Any public policy of the State or federal government could thus be easily subverted.

I.

When the primary purpose of an agreement is illegal, a federal court cannot enforce the agreement by awarding contract damages for breach any more than it could enforce the agreement by ordering specific performance.

The primary and indeed only purpose of the Agreement was to lease the aircraft for registration and use by TCA in the United States. This would have been illegal. A federal court therefore cannot enforce the agreement by awarding contract damages as if such registration and use would have been legal.

> "No court should encourage violation of the clear statutory policy by enforcing performance of such a contract —whether by awarding specific performance . . . or damages for not performing. . . ." *Alleghany Corp.* v.

James Foundation of New York, Inc., 214 F. 2d 446, 450 (2d Cir. 1954), *cert. denied*, 348 U. S. 913 (1955).

See the other authorities also cited in American's main Brief at 29.

This principle applies even if one assumes that the arbitration award, despite its silence on the issue, determined that registration and use would have been legal. The doctrines of res judicata and collateral estoppel have been "rejected or qualified in cases in which an inflexible application would have violated an overriding public policy," 1B Moore, *Federal Practice* ¶0.405[11], at 783 (1965), or would have conferred a right or protection contrary to federal law, *La Societe Anonyme Des Parfums LeGalion* v. *Jean Patou, Inc.*, 495 F. 2d 1265, 1274-76 (2d Cir. 1974). See *Spilker* v. *Hankin*, 188 F. 2d 35, 38 (D. C. Cir. 1951); *Denver Bldg. & Constr. Trades Council* v. *NLRB*, 186 F. 2d 326, 332 (D. C. Cir. 1950), *rev'd on other grounds*, 341 U. S. 675 (1951); Restatement (Second) of Judgments § 68.1 (e)(i), at 171 (Tent. Draft March 28, 1973); *cf. Alexander* v. *Gardner-Denver Co.*, 415 U. S. 36, 49 (1974); *Griffin* v. *State Board of Education*, 296 F. Supp. 1178, 1182 (E. D. Va. 1969); Article V, paragraph 2(b), of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of June 10, 1958, 9 U. S. C. § 201, 84 Stat. 692 (July 31, 1970).

The public policy at issue here is that of promoting a domestically-owned air fleet—not, as AET suggests, of enabling "TCA . . . to effectively compete with much larger carriers." AET's Brief at 41.* Congress has enforced this policy by absolutely barring foreign-owned aircraft from internal air commerce and by permitting only domestically-owned aircraft to share in the revenues of such commerce. The primary and sole objective of the leasing arrangement squarely violated that policy: the Agree-

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* In fact, such TCA competition would have been "unfair". The cheap rent TCA was to pay AET reflected the fact that AET had received Ex-Im Bank financing at much lower rates than were available to the U. S. carriers who were TCA's competitors. Furthermore, AET itself, by thus tapping U. S. domestic revenues through the lease to TCA, would have bolstered its own ability to compete on the North Atlantic routes against U. S. carriers who could not obtain low cost Ex-Im Bank financing. AET's policy argument is thus erroneous as well as irrelevant.

ment sought to lease foreign aircraft to TCA for registration and use in the United States, and to allow AET to share in the revenues of domestic air commerce by receiving rents from income generated by such commerce. A federal court, therefore, cannot properly exercise its power to enforce such an agreement by awarding damages for its breach. See *Kaiser-Frazer Corp.* v. *Otis & Co.*, 195 F. 2d 838, 843-44 (2d Cir.), *cert. denied*, 344 U. S. 856 (1952) ("the contract was so closely related to the performance of acts forbidden by law as to be itself illegal").*

AET claims that the arbitrators decided that registration would be legal, and that the federal court must blindly accept that determination and *exercise its power affirmatively* to enforce the Agreement, even if registration is not legal. Under this reasoning, if the Agreement required American to register the aircraft, the federal court would be obliged to issue such an order, even if registration were illegal. Obviously the court would not do so. Here, contract damages are sought instead, but the effect is the same. See *Alleghany Corp.* v. *James Foundation of New York, Inc., supra.* Either way, the federal court would be enforcing an agreement which was intended to place foreign aircraft in domestic commerce. The court would therefore be frustrating congressional policy by affirmatively enforcing and encouraging the very kind of leasing arrangement which Congress has forbidden. The case for not doing so is much stronger here than it was in *La Societe Anonyme Des Parfums LeGalion* v. *Jean Patou, Inc., supra*, 495 F. 2d at 1276, where this Court expressed an unwillingness to apply res judicata when such an application would have the consequence of giving permanent protection to a party's trademark maintenance program which was insufficient under federal law. Here, the question is not simply whether to leave a party better off than federal law provides; it is whether the Court's power should be

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* It is crucial for the Court to recognize that any action for damages by AET must be brought as an action on the contract itself, *not* as an action on the arbitration award. The award in this case, unlike the usual arbitration award, did not grant damages to AET in settlement of the case. Rather, remedies were specifically left for a subsequent action to enforce the contract. Thus, the question here is simply: can this Court or any court enforce *this* Agreement? The plain fact is that it cannot.

affirmatively exercised to enforce an agreement, the objective of which was directly contrary to federal law.*

AET apparently concedes that a federal court should not enforce a contract which seeks to accomplish unlawful objectives; nor does it dispute that the doctrine of res judicata should not be inflexibly applied in a manner which would subvert congressional policies. AET argues instead that these principles are inapplicable because neither the Agreement nor the award requires TCA to operate the aircraft in domestic commerce. See AET's Brief at 43. This argument ignores the purpose and provisions of the Agreement itself.

The Agreement expressly provided that TCA would have no obligation to pay rent if TCA could not lawfully register and use the aircraft *"in its operations"*. (A 38) (Emphasis added.) Section 19.2 of the lease form stated that if TCA were unable to "effect registration . . . under Section 501" of the Federal Aviation Act, or if TCA were "unable to use the Aircraft in its operations" as a result of any federal law, then the lease in question would terminate without obligation. (A 38-39; see also A 41) Each lease thus contained its own "self-destruct" mechanism, and no matter how often or how diligently either or both parties tried to register the aircraft, they could never have been lawfully registered and could never have been lawfully used.** The best efforts requirement, and the companion provisions requiring real effort by both parties, merely assured that there would be no automatic termination unless there was a real

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* Suppose that competitor "A" obtained from three arbitrators (who misapprehended the Sherman Act) an award stating that a price fixing contract with competitor "B" was enforceable; and that A then sued B for lost profits because B in violation of the price-fixing contract had injured A's business by selling in the market beneath the fixed price. Would a federal court enforce the contract by awarding damages to B?

** It was this automatic termination provision which helped "save" the Agreement itself from being illegal, despite its objective. The provision clearly placed the risk of legal inability either to register or to use on AET. AET's argument—that TCA would owe all of the rents even if it could not legally register or use the aircraft—is thus squarely contradicted by the explicit provisions of Section 19.2. See AET's Brief at 43 and 33.

legal inability to register or a real legal inability to use the aircraft. But the controlling factor was the inability to register or the inability to use, not the means by which that inability was demonstrated. That is the explicit and clear meaning of these provisions.

AET argues that the parties agreed on a detailed procedure for registering the aircraft and that, since TCA did not follow this procedure, American is precluded from asserting nonliability. AET's Brief at 31. This argument is pure fiction. There was no agreed-to "procedure" for registering; there was merely the unambiguous provision, referred to above, that no obligation would be owing if the aircraft could not be registered and used.

Under AET's construction of the Agreement, TCA would have been required to plod dutifully through the motions of attempting to register the aircraft in November 1970 even if it were crystal clear that, best efforts or no, the planes could not be lawfully registered. In the meantime, TCA would have been required to continue spending hundreds of thousands of dollars preparing to accept delivery of the first aircraft in November, and to no avail. All this would be true even if a court or a federal agency had already definitively ruled that registration was unlawful. Anything less, AET argues, constituted a default; anything less permits AET to recover all of the rents. But TCA was obviously not agreeing, nor was it expected to agree, to pay if it could not lawfully fly the aircraft. Certainly it was not contracting to pay to have the aircraft sit on the ground, or to store them in a hangar, or to sublease them to someone else. AET's arguments to the contrary are contradicted both by common sense and by the provisions of the lease form and Agreement. (See A 38-39; A 41)

II.

The aircraft could not have been lawfully registered and used by TCA under any circumstances.

AET cannot seriously dispute the existence of a well-established congressional purpose to foster the development of a home-owned air fleet (a) by prohibiting the use of foreign-registered aircraft on domestic routes, and (b) by prohibiting the

U. S. registration of foreign-owned aircraft.* See American's Brief at 29-40.

Ignoring the legislative purpose, AET tries to create ambiguity where none exists in the definition of conditional sale in Section 101(16) of the Federal Aviation Act, 49 U. S. C. § 1301(16). AET recognizes that part "a" of the definition describes the usual conditional sales contract but argues that part "b" "covers something else". AET's Brief at 37. However, it is crystal clear from the language and statutory history of part "b" that part "b" simply meant to include bailments and leases which were equivalent to the usual conditional sales contract described in part "a".

The definition set forth in Section 101(16) was taken almost verbatim from the Uniform Conditional Sales Act.** The comments of the National Conference of Commissioners on Uniform State Laws explain the meaning of part "b" and illustrate when a lease is equivalent to the conventional conditional sales contract of part "a":

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* In discussing the prohibition against the use of "foreign civil aircraft" on domestic routes, AET's Brief at page 41 deals with only one of the two prohibitions. Section 1108 of the Federal Aviation Act, 49 U. S. C. § 1508, bars foreign registered aircraft from domestic routes. But Section 501(a) of the Act, 49 U. S. C. § 1401 (a), also limits eligibility for U. S. registration to aircraft owned by U. S. citizens and bars from domestic routes *"any aircraft not eligible for registration"*. Taken together, these prohibitions bar both a foreigner *and* a U. S. citizen from using foreign-owned aircraft on domestic routes.

** The Uniform Conditional Sales Act definition of conditional sale reads as follows: "§ 1. Definition of terms.—In this Act 'Conditional sale' means (1) any contract for the sale of goods under which possession is delivered to the buyer and the property in the goods is to vest in the buyer at a subsequent time upon the payment of part or all of the price, or upon the performance of any other condition or the happening of any contingency; or (2) any contract for the bailments or leasing of goods by which the bailee or lessee contracts to pay as compensation a sum substantially equivalent to the value of the goods, and by which it is agreed that the bailee or lessee is bound to become, or has the option of becoming the owner of such goods upon full compliance with the terms of the contract." 2 Uniform Laws Annotated ("U. L. A.") § 1 (1922).

> "This equivalency seems to exist when the buyer is bound to pay rent substantially equal to the value of the goods and has the option of becoming or is to become the owner of the goods after all the rent is paid. *In such a contract 'rent' means the purchase price*, and possession as 'lessee' means the possession of a buyer under an executory contract of sale. *That the buyer, in some cases, has the option of becoming the owner and thus a sale is not sure to take place, is of but small importance, for, as a practical matter, the buyer will always be willing to accept ownership when he has paid the value.* The instances of a buyer declining to become the owner of goods where he has paid 'rent' equivalent to the value of the goods, and electing to return the goods and allow these payments to be considered as actual rent, must be exceedingly infrequent." 2 U. L. A. at 3. (Emphasis added.)

It is therefore plain that if a U. S. purchaser is in the process of actually buying an aircraft on time payments, he is a conditional vendee within the meaning of Section 101(16), whether the contract is called a conditional sales contract or a bailment or a lease. But it is equally clear that he is only a lessee when he is *not* buying the aircraft—when (as here) the rents are not credited towards the purchase price, the option price has not been paid by the end of the lease term, and the option is not "the option of becoming the *owner*" but only the option of becoming the *purchaser*. This is what the statute means, and this is in accord with the intended congressional purpose of permitting only U. S.-citizen owners to register aircraft.*

AET's contention that "the FAA" has followed a wooden routine of registering all leases with options to purchase as "contracts of conditional sale", and that this routine is entitled to "great weight" in interpreting statutes, is completely specious.

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* AET's discussion of safety considerations is completely irrelevant. Although safety is of course one aspect of the FAA's responsibilities, it is dealt with in a separate Subchapter of the Federal Aviation Act, see 49 U. S. C. §§ 1421-29 (Subchapter VI), and in different Parts of the FAA's Regulations, see, *e.g.*, 14 C. F. R §§ 21-35, 61-67, and does not bear at all on the registration and cabotage matters under discussion here.

First, "the FAA" does not have and never had such a routine. AET is trying to blow up into an "FAA practice" a legally indefensible filing convenience which grew up as a short-cut for clerks in the Registry Office in Oklahoma City. These clerks had no awareness of the legal issues we are discussing here.* In fact, since the Registry's dealings are almost exclusively with U. S. citizens on *both* sides of transactions, it is not surprising that they would be ignorant of the issue. For only when a foreigner was involved would it make any difference on the cabotage issue in which name the aircraft were registered.

Second, the "routine" to which AET refers was never approved by the FAA in Washington or by its General Counsel or, in fact, by anyone at the FAA who understood the question. It never could have been approved because it not only contradicted the statute but also mocked the underlying congressional purpose. For that reason it is entitled to no weight at all. That AET or its counsel learned of this procedural lapse and used it to their own advantage two or three times before the TCA deal does not demonstrate that the registration is legal; it does, however, suggest that the Irish knew what they were doing all

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* This is how AET managed to have a few short-term leases on its smaller aircraft processed in Oklahoma City prior to 1970. These leases, long since expired, were flagrantly illegal. The clerks in the Registry Office (and even their supervisors), like their counterparts in many federal depositories, make only the most superficial review of the face of the documents submitted for filing purposes. They are easy to fool. Indeed, the lease form attached to the Agreement was carefully entitled "Aircraft Lease Agreement with Option to Purchase" just so it would routinely be passed through without questions. The Regulations recognize that the Registry has neither the number nor the type of personnel to evaluate such matters. *That is why Section 47.43(a) of the Regulations, 14 C. F. R. § 47.43(a), makes it clear that the fact of registration is no test of the validity of registration.* This is also perhaps why the registration application form recites that it is a criminal offense for an applicant to make a false statement on the form—a form which requires the applicant to state whether he is the owner of the aircraft. (A 183)

along in trying to place their aircraft off-season in revenue-generating service on forbidden U. S. cabotage routes.*

Finally, the only clear and unambiguous FAA authority on the registration question now before this Court is the opinion letter of November 3, 1970 from the FAA General Counsel's office. AET persuaded the District Court that the November 1970 opinion letter was not a "formal opinion". But the FAA's own regulations demonstrate that until the FAA actually refuses to register an aircraft or revokes an aircraft registration, an opinion in writing from its General Counsel is as authoritative an expression of opinion as one can obtain from the FAA.** And despite the disingenuous posture it has taken in *this* litigation and in the "rent action", 73 Civ. 2933, now pending in the District Court, AET has alleged in two other separate actions it has also filed in the District Court, 73 Civ. 2473 (I. B. W.) (a tort action against American), and 74 Civ. 3124 (L. W. P.) (an antitrust action against American), *all based on precisely*

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* The cabotage restrictions at issue here are not unique to the United States. As shown by the authorities cited in American's Brief at 32-36, these restrictions, with variations due to different economic and national defense considerations, exist in most major countries of the world, including Ireland. AET, an experienced international airline, must have been aware of the problem.

** Unlike the C. A. B. or the S. E. C., which are independent agencies operating under the direction of a board or group of commissioners, the FAA is directed by a single administrator and is a part of the Executive branch within the Department of Transportation. As a consequence, the Office of General Counsel "has overall responsibility for the legal activities of the Agency . . . and conducts the Agency litigation, ruledrafting and interpretation . . . programs." 30 Fed. Reg. 3398 (March 13, 1965), 1A CCH Fed. Aviation L. Rep. ¶10,102, at 4186. Since AET's precipitous termination of the Agreement on September 2, 1970 prevented any adjudicative or enforcement action by the FAA, see 14 C. F. R. § 13.19, the Shienbrood letter provided the most authoritative FAA opinion then available as to the registrability of AET's aircraft. The affidavits of the FAA officials involved in the AET-TCA dispute (including Shienbrood himself) confirmed that the Shienbrood letter was in fact "a formal opinion" issued on behalf of the FAA. (A 278-79) The District Court ignored both affidavits.

these same facts, that the Shienbrood letter of November 3, 1970 *was* an FAA opinion which declared the aircraft nonregistrable and which has therefore driven AET out of the U. S. "leasing market". In other words, at the same time AET is telling this Court that registration is legal, it is pursuing two separate actions in the District Court grounded on the proposition that it cannot get its aircraft registered in the United States.

There is not the slightest doubt that AET's aircraft could not be legally registered and used in U. S. domestic air commerce. Consider, for example, AET's own actions in this regard:

> (1) In 1967, even before the Agreement was executed, AET's own lawyers warned AET that "in view of the successive leases the FAA might rule that the option to purchase feature was not a legitimate option but simply a subterfuge to permit the transfer of registration." (A 273)
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> (2) Although AET had long tolerated TCA's delay in tendering the $85,000 advance (originally due July 1, 1969) and the first executed lease (requested by AET on July 8, 1970), it decided to and did terminate on these grounds *one day* after American confirmed that it was seeking an FAA opinion. When TCA then tendered the payment and lease within days, AET rejected the tender. Obviously it was trying to avoid the fact, fatal to the Agreement, that registration would have been illegal, and to collect millions in windfall rents as if its aircraft could have been registered.
>
> (3) When American thereafter invited AET to meet jointly with TCA and the FAA's General Counsel to resolve the registration issue, AET refused. When the FAA itself contacted AET and asked if it wished to present its views, AET again refused. All of this occurred many weeks before the opinion letter was issued by the General Counsel's office.
>
> (4) After both the Demand for Arbitration and TCA's Answering Statement had been filed, AET empha-

> sized to the arbitrators that "there can be no issue as to registrability of the aircraft [in this arbitration]."

In short, AET knows and has always known that its aircraft cannot be lawfully registered in this country. Its every effort has been to obfuscate and dodge that fundamental defect in the Agreement. So far it has succeeded, first by bifurcating the arbitration and then by acting as if the arbitration had decided that registration was legal.* No such determination was made by the arbitrators and, even if it had been, this Court—as we have shown—cannot give effect to such a determination.

III.

The registration issue was neither submitted to the arbitrators, nor decided by them, and it is pure speculation to say that they did decide it.

The arbitration "pleadings" put in issue AET's default claims, TCA's mootness claim, and TCA's claim for a declaration of no liability, but not the question of registration itself. The pleadings treated the question as already settled by the FAA, the agency with primary responsibility for administering the registration statute; non-registrability was simply the premise for TCA's mootness defense and for its counterclaim. AET not only did not contest this premise in any pleading but, on the

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* TCA of course objected to the bifurcated arbitration, with default questions to be decided in a vacuum, divorced from any consideration of remedies. AET responded "that *this is precisely what the parties agreed to.*" (A 169, 193) (Emphasis in original.) The state court accepted AET's distinction. Since both sides agreed that remedies were not to be arbitrated, and since the only question on the stay proceedings was whether under those circumstances defaults alone could be arbitrated, the scope and enforceability of remedies—including registration as it affected remedies, and punitive damage defenses and causation as they affected remedies—were irrelevant to the stay proceedings, and no such questions were waived by not being litigated in the stay proceedings.

contrary, asserted in its pre-hearing memorandum to the arbitrators that the legality of registration was irrelevant. (A 253)

AET quotes out of context an extract from American's post-hearing arbitration brief, asserting that the extract demonstrates that American asked the arbitrators to second-guess the FAA and to re-decide the legality of registration. See AET's Brief at 14-15. But when the extract is examined in context, as shown at A 281, it is clear that the quoted part of the brief was directed to the question of whether, in view of the registration statute and regulations, American's approaching the FAA violated TCA's best efforts obligation, and that it was not submitted in support of any request to the arbirators to decide whether registration would have been legal. (See A 281, 298-301) Similarly, AET's own arbitration evidence on registration, mentioned in AET's Brief at 13, was directed toward showing that the Registry Office "routine" would have permitted a registration application to coast through if no questions were asked; but as to the actual validity of registration, AET emphasized to the arbitrators that "the law on registration is not black and white" and that "there is no law on registration". (A 122) The ambivalence of these assertions shows that AET was not asking the arbitrators to pass upon the legality of registration itself.

Regardless of what was *submitted*, however, it is clear that no one can tell whether the arbitrators *decided* on the legality of registration. This is explained in American's main Brief at 18-23, and can be summarized briefly.

As to TCA's affirmative defense of mootness, the arbitrators may have concluded that AET's default claims were not necessarily moot even if registration would have been illegal; or, they may have decided that mootness was an irrelevant defense in the arbitration, since the arbitrators were only to decide whether there were defaults and were not required to consider whether remedies were moot or not moot. Thus, under the doctrine of collateral estoppel, which applies in determining whether the rejection of the mootness defense constituted a ruling that reg-

istration was illegal, it cannot be said that the arbitrators decided the point because *they did not necessarily have to do so* in order to reject the mootness defense. The award is silent on the subject of registration; it is consistent with a decision either way, or with no decision at all. And it is therefore pure speculation to say that the arbitrators decided the matter.

With respect to TCA's counterclaim for a declaration of no liability, the dismissal of that counterclaim without any statement of reasons does not make the dismissal res judicata on the matter of registration. As explained in American's main Brief at 22, the dismissal of a request for declaratory judgment without an affirmative declaration of the parties' rights is not a dismissal on the merits—which is essential for res judicata. And in the absence of a dismissal on the merits, courts simply do not foreclose a claim by speculating that it may have been decided on the merits when it cannot be shown that it was so decided.*

IV.

AET may not recover punitive damages regardless of what TCA did or did not warrant.

The District Court dismissed American's fifth claim, which alleged that the remedies in Section 9.2 of the Agreement were punitive and hence illegal, on the ground that TCA had warranted that they were not. This rationale is erroneous, and AET barely mentions it in its Brief. Compare American's main Brief at 44-47.

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* The state court confirmation proceedings, referred to in AET's Brief at 18-20, shed no light at all on the meaning of the award. As soon as American learned that AET was asserting in the District Court that the award decided that registration was legal, American moved for clarification in the state court, or for remand to the arbitrators for clarification, or for vacatur of the award if the state court concluded that it constituted a decision that registration was legal. The state court simply ignored the question. It confirmed the award, the meaning of which was being disputed, without saying what it meant.

AET's Brief also ignores Section 13.8 of the Agreement which, as we explained, explicitly declares ineffective any provision of the Agreement that it unlawful or unenforceable. That Section shows that the warranties in the Agreement were never intended to cover unenforceable punitive damage provisions.

Instead of trying to support the District Court's reasoning, AET argues that Section 9.2 is not punitive. It begins by asserting that Section 9.2 was agreed to by TCA—a truism that can be said of any punitive damage provision—and that, in any event, Section 9.2 is not penal—a subject which the District Court did not analyze and which cannot be decided, at least against the party opposing the motion, on a motion for summary judgment.

We note, moreover, that the fundamental punitive characteristic of Section 9.2 was that it provided enormous damages, more than $13 million in rents, for trivial, inconsequential defaults.

> "[S]etting a fixed amount [of damages] for any breach irrespective of its gravity or the probable damage to be contemplated might well . . . [constitute] an unenforceable penalty." *Bradford* v. *New York Times*, 501 F. 2d 51, 57 (2d Cir. 1974) (dictum).

See 5 Corbin, *Contracts* § 1066, at 379 (1964) (when "amount made payable [under the contract] is the same without regard to the extent of injury done by the various breaches . . . such a penalty is not enforceable").

Here, for example, both of the defaults for which AET terminated were trivial. See American's main Brief at 8. There is an obvious disparity between these trivial defaults and the huge contract forfeiture—all the rents for nothing—which AET claims is the consequence of Section 9.2. The test of whether a damage provision is punitive is whether a trivial default *could* invoke it. This is the "weakest link" test referred to previously at page 46 of American's main Brief. AET's argument—specious though it is—has always been that the Agreement made no distinction between trivial or major defaults. *Any* default, according to AET, gave it the automatic, unquestionable right to invoke

all the drastic remedies of Section 9.2. AET's position is a confession, under the weakest link test, that Section 9.2 is unenforceable. This is plain on its face, but even if it were not, the fifth claim could not be dismissed without a trial.*

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* Several specific provisions of Section 9.2 are also penal:

1. AET can accelerate, to the beginning of each seasonal period, all the rents for the entire period, without any interest credit to TCA. This is pure penalty and gives AET more than it would have obtained if the Agreement had been performed.

2. AET can alter the aircraft for reletting and charge TCA the cost. Yet, it credits TCA only net rentals from reletting, deducting such costs as if AET had paid them. Thus it gets the costs twice.

3. AET asserts, although the Agreement is to the contrary, that it is entitled to collect the rents through the 5-year term without taking into account any credits due from AET's reletting or use of the aircraft, and that these credits are applied only after the end of the 5-year period, in May 1975. Under this interpretation, AET could relet the aircraft at a much higher rental for the entire period of the Agreement and collect both that extra rent, and full rent from American, without having to credit American until after May 1975. This too is obviously a penalty.

4. AET has in effect locked out TCA from any access to the aircraft over a 5-year period while seeking to charge TCA the full rents. Even if AET had a right to reject TCA's tender of the advance payment and lease, it could not do so and still claim all of the rents. See *Parsons* v. *Sutton*, 66 N. Y. 92, 99 (1876). Under these circumstances the rents would be purely punitive.

5. In fact, under the Agreement AET has built into the rent computation charges which relate to various modifications and changes which AET had made in the aircraft since it terminated and for which it seeks to charge TCA as if TCA were using the planes and benefitting from the modifications. These charges too are a penalty.

V.

This action should not have been dismissed under the court's discretionary power.

As pointed out in American's main Brief at pages 47-49, AET has filed the rent action in the District Court, 73 Civ. 2933, also pending before Judge Wyatt, to enforce Section 9.2, the remedies provision of the Agreement, and to collect the rents as damages. Subsequent to the filing of our main Brief, AET on August 2, 1974 moved in the District Court for summary judgment in the rent action, asserting that on the basis of Judge Wyatt's opinion and order in the present case, summary judgment should be granted in the rent action. It is therefore essential on this appeal that the Court deal with the substantive errors in the District Court's opinion. This is true even if the Court were to affirm only that part of the District Court's opinion holding that the complaint for declaratory relief may be discretionarily dismissed. Otherwise, all these errors will be repeated and compounded in the rent action and will again be brought before this Court on appeal. It is wasteful not to resolve these issues now.

CONCLUSION

Since the Agreement by its own terms provided that it would terminate if the aircraft could not be lawfully registered and used by TCA, and since such registration and use would have been illegal regardless of what the parties did, the decision of the District Court should be reversed and the case remanded with instructions to enter summary judgment for American on the first three claims. If the Court has any doubt as to the issue of registration, it should in the alternative reverse and remand with instructions that the case be consolidated for trial with the rent action and that the District Court seek the participation of the Federal Aviation Administration in order that it can be shown that there is no way in which the Agreement could

lawfully have been performed. We believe, however, that nothing would be gained by further analysis, as the statutory purpose and provisions are clear.

The fourth and fifth claims, as shown, should not have been dismissed without a trial and, accordingly, reversal is warranted on those claims.

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Respectfully submitted,

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